

Roll No. ....

FINAL  
GROUP-II PAPER-7  
DIRECT TAX LAWS

NOV 2016

Total No. of Questions – 7

Total No. of Printed Pages – 15

Time Allowed – 3 Hours

Maximum Marks – 100

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Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

Question No. 1 is compulsory.

Answer any **five** questions from the remaining **six** questions.

In case, any candidate answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Wherever necessary, suitable assumptions may be made and disclosed by way of note.

Working notes should form part of the respective answers.

All questions relate to **Assessment year 2016-17**, unless stated otherwise in the question.

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1. (a) **KDS Realty Trust.**, a business trust registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, provides the following particulars of its income for the previous year 2015-16:
- (i) Rental income ₹ 3 crore, from the directly owned real estate assets;

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- (ii) Short term capital gain ₹ 1.5 crore, on sale of listed shares of Brahma Ltd., an Indian company in which KDS Realty Trust holds controlling interest through holding 60% of the shareholding of Brahma Ltd.
- (iii) Short term capital gain ₹ 2 crore, on sale of developmental properties;
- (iv) Interest ₹ 1 crore, received from investments in unlisted debentures of real estate companies;
- (v) Dividend ₹ 3.5 crore from Brahma Ltd.

**Other Information:**

KDS Realty Trust has distributed ₹ 10 crore to its unit holders in the previous year 2015-16.

Discuss the tax implications (including TDS implications) based on the above income earned by KDS Realty Trust, both in the hands of KDS Realty Trust and its unit holders in the previous year 2015-16.

- (b) Mr. Raghu purchased 10,000 equity shares of AB Avenues Private Limited on 25-05-2004 for ₹ 1,20,000. The company went into liquidation on 31-07-2015. The following is the summarized financial position of the company as on 31-07-2015. 10

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Liabilities	₹	Assets	₹
60,000 equity shares of ₹ 10 each	6,00,000	Agricultural lands in urban area	22,00,000
General reserve	40,00,000	Cash at bank	32,14,305
Liability for income tax	8,14,305		
	<b>54,14,305</b>		<b>54,14,305</b>

The assets remaining after discharging liability for income tax were distributed to the shareholders in the proportion of their shareholding. The market value of agricultural land as on 31-07-2015 is ₹ 60,00,000.

The agricultural land received as above was sold by Mr. Raghu on 28-02-2016 for ₹ 15,00,000.

Discuss the tax implications in the hand of the company and Mr. Raghu.

The cost inflation indices are F.Y. 2004-05 : 480 and F.Y 2015-16:1081.

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2. Statement of Profit & Loss of BM Private Ltd., a resident company engaged in manufacturing, shows net profit of ₹ 90,00,000 for the financial year ended on 31<sup>st</sup> March, 2016 after debit/ credit of the following items. 16

**A. Credited to the Statement of Profit and Loss:**

- (i) Rent received from vacant land ₹ 1,20,000
- (ii) Rent received (gross) from a commercial property owned by the company ₹ 2,50,000 (Tax deducted by tenant @ 10%)
- (iii) Interest received on income tax refund ₹ 1,00,000
- (iv) Profit on sale of unused land ₹ 10,00,000

**B. Debited to the Statement Profit and Loss :**

- (i) Depreciation charged to the Statement of Profit and Loss ₹ 12,00,000.
- (ii) Donation of ₹ 1,00,000 paid to Swachh Bharat Kosh.
- (iii) Contribution to Political Party amounting to ₹ 2,00,000 paid in cash.
- (iv) Payment made to transporter ₹ 1,00,000 by account payee cheque, but no tax has been deducted at source. (Transporter is having PAN and furnished declaration that he is covered under Section 44AE and not having more than 10 goods carriages at any time during the previous year)
- (v) Bonus to employees ₹ 2,00,000 provided. However, payment was made on the occasion of Diwali festival on 18<sup>th</sup> October, 2016.

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- (vi) Provision made for income tax ₹ 3,00,000 (including interest of ₹ 50,000 thereon)
- (vii) Contribution of ₹ 1,00,000 to a University approved and notified under Section 35(1)(ii)
- (viii) Loss of ₹ 2,50,000 incurred by way of trading in futures and options (derivatives) in stocks in a recognized stock exchange.

**Additional information:**

- (1) Depreciation as per Income Tax Act, 1961 ₹ 20,00,000. However, while calculating such depreciation rate applicable to computers has been adopted for (i) accessories like printers and scanners, and (ii) EPABX. The written down value of these items as on 01.04.2015 is given below:

(a) Printers and scanners ₹ 3,00,000

(b) EPABX ₹ 5,00,000

- (2) Additional Depreciation on Plant and machinery purchased for ₹ 20,00,000 on 15<sup>th</sup> October, 2015 has not been considered while calculating depreciation as per Income tax Act, 1961 as above.

- (3) Provision for audit fee ₹ 1,00,000 was made in the books for the year ended on 31<sup>st</sup> March, 2015 without deducting tax at source.

Such fee was paid to auditors in September 2015 after deducting tax at source under Section 194J and tax so deducted was deposited on 6<sup>th</sup> October, 2015.

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- (4) The Company during the financial year 2013-14 made a provision for an outstanding bill of ₹1,00,000 for purchase of raw material. Out of such outstanding amount the company has paid ₹ 50,000 in cash on 15<sup>th</sup> September, 2015.
- (5) During the year the company has issued 1,00,000 equity shares of face value of ₹ 10 each at premium of ₹ 90 each. The fair market value is ₹ 60 per share at the time of issue of shares.
- (6) Unused land which was sold during the year for ₹ 50,00,000 was acquired by the Company in the financial year 2012-13 for ₹ 40,00,000.
- (7) Cost Inflation Index- FY 2012-13: 852; FY 2015-16 : 1081

Compute total income of the company for the Assessment Year 2016-17 stating reasons for treatment of each item. Ignore provisions relating to Minimum Alternate Tax.

3. (a) As per agreement between S Limited, a company incorporated in Korea and Bharti Motors Limited, an Indian company, S Limited rendered both off-shore and on-shore technical services to Bharti Motors Limited for setting up a car manufacturing plant in Gujarat. S Limited rendered off-shore service services and on-shore services at fee of ₹ 2 crore and ₹ 3 crore respectively. S Limited claims that it is not liable to tax in India in respect of fee of ₹ 2 crore as it is for rendering services outside India. Is the view taken by S Limited correct ? 4

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- (b) Keeping in view that Yoga is the present focussed area and has been granted international recognition by the United Nations Organisation (UNO), an institution called "Hindusthan Mahan" having 'Yoga' as its main object was registered under Section 12AA. For the previous year 2015-16, the total receipts of the institution are ₹ 135 lakhs including ₹ 26.5 lakhs from business activity. 6
- (i) State with reasons whether the institution will continue to retain its "Charitable Status" and be eligible for exemption under section 11 for the Assessment Year 2016-17.
- (ii) What would have been the effect, had the main object of the institution been "advancement of any other object of general public utility" and it had applied its receipts from business activities towards such main object ?
- (c) During the previous year 2015-16, Ms. Indu, a citizen of India is a resident of both India and a foreign country with which India has a Double Tax Avoidance Agreement (DTAA), which provides that "the income would be taxable in country where it is earned and not in other country, but would be included for computation of tax rate in such other country". Her income is ₹ 3,25,000 from business in India and ₹ 6,00,000 from business in foreign country. In foreign country the rate of tax is 20%. During the year she paid a premium of ₹ 32,000 to insure the health of her mother, a non-resident, aged 82 years, not dependent on her, through her credit card. 6
- (i) Compute the tax payable by Ms. Indu in India for the A.Y. 2016-17.
- (ii) Also, show the tax payable by Ms. Indu in India, had there been no DTAA with such foreign country.

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4. Answer any **four** out of the following five cases.

**4x4=16**

- (a) Mr. Ankit sold a plot during the financial year 2015-16 and invested the sale proceeds in purchase of a new house in the name of his wife by the end of the financial year i.e. 31<sup>st</sup> March, 2016. He claimed deduction under Section 54F in respect of the new house purchased by him in the name of his wife. The Assessing Officer while making assessment for the Assessment Year 2016-17 denied such deduction on the ground that in order to avail benefit under section 54F, it is necessary to invest the sale proceeds in the name of the assessee.

Comment on the validity of action taken by the Assessing Officer.

- (b) Bahubali Co-Operative Housing Society is a registered co-operative housing society. It is formed with the objective of maintaining the property owned by it. It effects repairs and maintenance of the common property of the members and confers the usual rights and privileges to its members. During the year ended 31<sup>st</sup> March, 2016, Mr. X transferred his membership to Mr. Y for which the society received transfer fees of ₹ 5.50 lakhs each from Mr. X and Mr. Y. Mr. Y was not a member of the society at the time of transfer. In course of assessment of the society under section 143(3) the Assessing Officer charged transfer fees to tax under the head "profits and gains of business or profession".

Is the action of the Assessing Officer correct ?

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- (c) MNO Ltd., a listed company, wanted some credit facilities from the bank for its business purpose. The bank insisted on personal guarantee of the directors as a precondition for providing financial assistance to the company. The directors were employees of the company who were drawing salary from the company. A resolution was passed for paying commission to the directors and a sum of ₹ 24.50 lakhs each was paid as commission calculated at the rate of 1.5% of the principal sum, in respect of which personal guarantee was furnished by the directors to the bank.

The assessee claimed the expenses as business expenditure. But applying Section 36(1)(ii) the Assessing officer held that if the amount was not paid to them as commission, the same would have been payable as dividend and contended that the assessee avoided the dividend distribution tax under Section 115-O which was otherwise payable.

Is the action of the Assessing Officer valid ?

- (d) Wellcare Warehousing Ltd. engaged in the business of warehousing, handling and transport along with the relevant auxiliary services like pest control, rodent control, fumigation and security etc. Statement of profit and loss of company shows that the main source of income is storage charges and maintenance or user charges. The substantial part of expenses relate to salaries of employees engaged in maintenance and upkeep of warehouses. The company has filed return of income showing income from letting out of buildings and godown space as "Income from Business". The Assessing Officer rejected the view of the assessee and assessed the same as "Income from House Property".

Comment on the validity of action taken by Assessing Officer.

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- (e) ST & Co., a partnership firm was dissolved and as per the dissolution deed of the partnership firm, with effect from 18<sup>th</sup> September, 2004, S, one of the partners of erstwhile firm took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then continued the business as a sole proprietor with effect from that date. The assessee, relying upon Section 78(2) claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business. The claim of the assessee was disallowed by the Assessing Officer.

Examine the correctness of the action of the Assessing Officer.

5. (a) ABC Private Ltd. was converted into a limited liability partnership **8**

(LLP) called ABC LLP on 01-07-2015. You are provided with the following particulars of ABC Private Limited as on 31-03-2015:

- (i) Unabsorbed depreciation ₹ 13 lakhs.
- (ii) Business loss ₹ 10 lakhs (relating to previous year 2007-08).
- (iii) Unadjusted MAT credit under Section 115JAA ₹ 8 lakhs.
- (iv) Written down value of the assets as per Section 43(6) of the Income-tax Act.

Plant and Machinery (15%) ₹ 10 lakhs (market value ₹ 15 lakhs)

Plant and machinery ₹ 50 lakhs (Cost)- deduction claimed under Section 35AD

Building (10%) ₹ 20 lakhs (market value ₹ 30 lakhs)

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- (v) Cost of land (acquired in year 2000) ₹ 50 lakhs (market value ₹ 100 lakhs)
- (vi) Expenditure on voluntary retirement incurred by the company during the previous year 2013-14 is ₹ 25 lakhs. The company has been allowed deduction of ₹ 5 lakhs each year for the previous year 2013-14 and previous year 2014-15 under Section 35DDA.

Explain the tax treatment of each item stated above in the hand of LLP, assuming that the conversion satisfies all the conditions laid down in Section 47(xiiiib).

- (b) Chennai Co-Operative Society derives income during financial year 2015-16 from the following sources: **5**

- |  |            |
|--|------------|
| (i) Income from processing with the aid of power                 | – ₹ 20,000 |
| (ii) Income from collective disposal of labour of its members    | – ₹ 30,000 |
| (iii) Interest from another co-operative society                 | – ₹ 15,000 |
| (iv) Income from House property                                  | – ₹ 90,000 |
| (v) Income from other business                                   | – ₹ 60,000 |
| (vi) Income by way of dividend from another co-operative society | – ₹ 25,000 |

Determine its total income for Assessment Year 2016-17.

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- (c) After completion of regular assessment on February 22, 2014, Mr. Anshul received a notice on October 12, 2015 under Section 148 for Assessment Year 2013-14 on the ground that excess depreciation was allowed on certain assets. The Assessing Officer recorded the reason for re-opening. In the course of reassessment proceedings the Assessing Officer also disallowed certain expenses incurred in relation to dividend and tax-free interest, without recording the reasons for applying Section 147 on disallowance of such expenses. The Assessing Officer passed the order disallowing the excess depreciation and certain expenses under Section 14A. 3

Mr. Anshul seeks your opinion on the correctness of action of the Assessing Officer. Advise him.

6. (a) NANO Inc., a German Company holds 45% of equity in Hitech Ltd., an Indian Company. Hitech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes NANO Inc. 6

During the financial year 2015-16 Hitech Ltd. had spent 2400 man hours for developing and maintaining software for NANO Inc. with each hour being billed at ₹ 1,300. Cost incurred by Hitech Ltd. for executing work for NANO Inc. amounts to ₹ 20 lakhs.

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Hitech Ltd. had also undertaken developing software for Modi Industries, for which Hitech Ltd. had billed at ₹ 2,700 per man hour. The persons working for Modi Industries and NANO Inc. were part of the same team and were of matching credentials and calibre. Hitech Ltd. made a gross profit of 60% on Modi Industries' work. Hitech Ltd.'s transactions with NANO Inc. are comparable to the transactions with Modi Industries, subject to the following differences:

- (i) NANO Inc. gives technical knowhow support to Hitech Ltd., which can be valued at 8% of the normal gross profit. Modi Industries does not provide any such support.
- (ii) Since the work for NANO Inc. involved huge number of man hours, a quantity discount of 14% of normal gross profits was given.
- (iii) Hitech Ltd. had offered 90 days credit to NANO Inc., the cost of which is measured at 2% of the normal billing rate. No such discount was offered to Modi Industries.

Compute arm's length price as per cost plus method and the amount of increase in total income of Hitech Ltd.

- (b) Discuss the tax implications under Section 56(2) in respect of each of the following transactions: 2×3  
=6

- (i) Mr. Anaimudi received a painting by Raja Ravi Verma worth ₹ 65,000 from his nephew by way of gift on his 25<sup>th</sup> wedding anniversary.

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(ii) Dodabetta's son transferred shares of Pir Panjal Ltd. to Dodabetta HUF without any consideration. The fair market value of the shares is ₹ 3 lakhs.

(iii) ABC Private Ltd. purchased 8,000 equity shares of Satarupas Private Ltd. at ₹ 72 per share from Ms. Yamuna. The fair market value per share on the date of transaction is ₹ 90.

(c) Share of member of an AOP / BOI in the income of the AOP / BOI is to be reduced from net profit for computing "book profit" for levy of minimum alternate tax with effect from Assessment Year 2016-17. Explain the rationale behind the amendment. 4

7. (a) Examine the applicability of provisions relating to deduction of tax at source and compute the liability, if any, for deduction of tax at source in the following cases for the financial year ended 31-03-2016: 3×2  
=6

(i) ₹ 80,000 towards interest on compensation credited to the account of the payee by Motor Accidents Claim Tribunal on 30-11-2015.

(ii) ₹ 2,50,000 paid on 30.09.2015 as consideration to Mr. B, a resident in India, on account of compulsory acquisition of his residential building acquired for laying railway tracks.

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- (iii) Ravi Kumar aged 67 years derived ₹ 6,00,000 as salary from his employer, XYZ Ltd. for the year ended 31-03-2016. The following details are provided by him to the employer :

<b>Particulars</b>	<b>₹</b>
Loss from self-occupied house property at Mumbai	2,00,000
Net loss from let-out property	2,00,000
Net loss from business activity	1,00,000
Interest income from bank	3,20,000

- (b) Answer the following in context of provisions of the Income-tax Act : **3×2**  
**=6**
- (i) Consequences of non-compliance of notice under Section 143(2).
- (ii) Circumstances under which the advance ruling becomes void.
- (iii) Can the Income Tax Appellate Tribunal impose penalty for concealment of income ?
- (c) "Orders of the Settlement Commission are binding in nature". Explain **4**  
the binding character of orders of the Settlement Commission in the context of the provisions contained in the Income-tax Act.

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